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November 8, 2002

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, Massachusetts 02110

Re: Commonwealth Electric Company d/b/a NSTAR Electric, D.T.E. 02-51

Dear Ms. Cottrell:

Enclosed please find the Brief of Commonwealth Electric Company d/b/a NSTAR Electric in the above-referenced proceeding.

Thank you for your attention to this matter.

Sincerely,

Robert N. Werlin

Enclosure

cc: Jody Stiefel, Hearing Officer (nine copies)
Richard J. Morrison, Esq.
David Fine, Esq.

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Commonwealth Electric Company d/b/a NSTAR Electric	)	D.T.E. 02-51

BRIEF OF COMMONWEALTH ELECTRIC COMPANY d/b/a NSTAR ELECTRIC

Submitted by:

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Dated: November 8, 2002

TABLE OF CONTENTS

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Commonwealth Electric Company d/b/a NSTAR Electric	))))	D.T.E. 02-51

BRIEF OF COMMONWEALTH ELECTRIC COMPANY d/b/a NSTAR ELECTRIC

I. INTRODUCTION

On September 13, 2002, Commonwealth Electric Company d/b/a NSTAR Electric ("NSTAR Electric" or the "Company") filed a petition (the "Petition") with the Department of Telecommunications and Energy (the "Department") for approval and authorization, pursuant to G.L. c. 164, § 14, as amended, to issue bank term loan agreements (the "Term Loans") in an aggregate amount not to exceed $150 million. As discussed herein, the record in this proceeding shows that the Company has met the Department's standard under G.L. c. 164, § 14 for the approval and authorization of the Term Loans. Accordingly, the Department should approve the Company's request to issue up to $150 million in Term Loans.[1]

II. DESCRIPTION OF THE PROPOSED FINANCING

A. The Term Loans

In this filing, NSTAR Electric seeks authorization for the issuance of evidences of indebtedness of up to $150 million in the form of Term Loans (Exh. CE-1, at 2) The

[1] The Department held an evidentiary hearing in this proceeding on October 25, 2002. In addition to the testimony presented at the evidentiary hearing. the record contains 16 exhibits in the proceeding (including the prefiled joint testimony of Philip J. Lembo and Emilie G. O'Neil — Exh. CE-1), and one response to a record request issued by the Department.

Company is proposing that it be accorded the discretion, based on market conditions, to enter into Terms Loans either: (1) at a fixed rate; or (2) at an adjustable rate that will vary with a market index designated at the time of such Term Loans, not to exceed an effective rate of 10 percent per annum (id. at 5, 7; Exh. DTE-1-7; see also Tr. 1, at 8).[2] The Term Loans would have a maturity greater than one year, but not to exceed three years, from the date of any such Term Loan (Exh. CE-1, at 7; Exh. DTE-1-5; Tr. 1, at 7-8). The proposed financing request will enable the Company from time to time on or prior to December 31, 2004 to enter into one or more Term Loans from a bank or a syndicate of banks (Exh. CE-1, at 4).

The net proceeds from the Term Loans will be applied: (1) to the payment at maturity of certain outstanding long-term indebtedness; (2) for the payment of capital expenditures for extensions, additions and improvements to the Company's plant and properties, or for the payment of obligations of the Company incurred for such expenditures; (3) for the refinancing of short-term debt balances; and/or (4) for general corporate purposes (id. at 2; Exh. DTE-1-3). More specifically, during the period of the finance order, the Company's cash requirements will include payment of the $21,962,404 principal amount of the Company's notes which will become due during the 2003-2004 period (Exh. CE-1, at 5; Exh. DTE-1-3),[3] payment of upcoming capital expenditures, estimated at approximately $65,000,000, primarily reflecting expenditures for major

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2 As described by Ms. O'Neil, the decision as to whether the Term Loans will be at a fixed or adjustable rate will depend on an evaluation of both the interest rates available at the time of issuance and forecasts of interest rates at that time (Tr. 1, at 8).

3 Of the $21,962,404 of those outstanding securities, $18,481,404 is due and payable within one year (Exh. CE-3, "Long-term debt due in one year"; RR-DTE-1).

transmission and distribution projects (Exh. CE-1, at 5; Exh. DTE-1-3). The Company may also refinance some or all of its short-term debt balances with long-term debt if market conditions warrant (Exh. CE-1, at 5; Exh. DTE-1-3).[4]

B. Capital Structure of the Company

As of June 30, 2002, the Company's capitalizable utility plant in service was $663,693,649, with accumulated depreciation of $233,439,610, resulting in net capitalizable utility plant of $430,254,000 (Exh. CE-1, at 4; Exh. CE-3; Exh, CE-4). Also as of June 30, 2002, the Company had issued and outstanding: (1) $51,099,300 Common Stock ($25 par value); and (2) $130,190,121 Premium on Common Stock (Exh. CE-1, at 2-3; Exh. CE-3; Exh. CE-4). The Company also has outstanding long-term notes under certain Loan Agreements dated December 31, 1986, November 29, 1989 and March 31, 1993 totaling $88,616,548, in principal amount (Exh. CE-1, at 3; Exh. CE-3; Exh. CE-4).[5] In addition, the Company holds long-term debt of $18,481,202 due in one year (Exh. CE-3; RR-DTE-1). Accordingly, the Company has a sufficient balance of total capitalizable plant, less reserves for depreciation, against which up to approximately $160,349,000 aggregate amount of debt securities may be authorized (Exh. CE-1, at 4; Exh. CE-4).

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4 As noted during the Department's evidentiary hearing, the Company will determine whether it will refinance some of its short-term debt with long-term debt using several factors, including: (1) consideration of whether its short-term debt balance is approaching its Federal Energy Regulatory Commission-authorized limit of $100 million; and (2) the differential in interest rates between short-term and long-term debt (Tr. 1, at 15).

5 In addition, the Company maintains credit arrangements with various banks totaling $190 million which provide for short-term borrowings by the Company (Exh. CE-1, at 3). As of June 30, 2002, the Company had $47.2 million outstanding (id.). During the Department's evidentiary hearing, the Company updated this figure to $45.2 million outstanding as of October 21, 2002 (Tr. 1, at 17).

III. STANDARD OF REVIEW

In order for the Department to approve the issuance of stock, bonds, coupon notes or other types of long-term indebtedness[6] by an electric or gas company, the Department must determine whether the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. Boston Edison Company, D.T.E. 00-62, at 2 (2000); Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II"), citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). In addition, the Department must apply the so-called net plant test set forth in G.L. c. 164, § 16.[7] Colonial Gas Company, D.P.U. 84-96 (1984).

The Supreme Judicial Court has found that, for the purposes of G.L. c. 164, § 14, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946). In cases where no issue exists about the reasonableness of management decisions regarding the requested financing, the Department limits its § 14 review to the facial

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6 "Long-term" refers to periods of more than one year after the date of issuance. See, e.g., Boston Edison Company, D.T.E. 00-62, at 2, fn.2.

7 When the Department approves an issue of new stock, bonds or other securities by a gas or electric company, it determines whether the fair structural value of the plant and of the land and the fair value of the nuclear fuel, gas inventories or fossil fuel inventories owned by such company is less than its outstanding stock and debt, and it may prescribe such conditions and requirements as it deems best adapted to make good within a reasonable time the impairment of the capital. See G.L. c. 164, § 16.

reasonableness of the purpose to which the proceeds of the proposed issuance will be put. Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990). Regarding the net plant test, a company is required to present evidence that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Colonial Gas Company, D.P.U. 84-96, at 5 (1984).

IV. THE COMPANY'S PROPOSAL MEETS THE DEPARTMENT'S STANDARD OF REVIEW UNDER G.L. c. 164.

In this case, the Company has demonstrated: (1) that the issuance of evidences of indebtedness in the form of the Term Loans is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14; and (2) that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding less retained earnings).

The record shows that the Company's stated purposes for the proposed Term Loans are legitimate purposes in meeting the Company's service obligations. The Company demonstrated that it intends to use the proceeds from the Term Loans: (1) to pay certain outstanding long-term indebtedness; (2) to pay for capital expenditures for extensions, additions and improvements to the Company's plant and properties, or for the payment of obligations of the Company incurred for such expenditures; (3) to refinance of short-term debt balances; and/or (4) to pay for general corporate purposes (Exh. CE-1, at 2; Exh. DTE-1-3; see also Tr. 1, at 15-16). The Department has approved the use of financing proceeds for these purposes in the past. See The Berkshire Gas Company, D.T.E. 00-36, at 9 (2000) (approved the use of financing proceeds to finance the company's liquefied natural gas facility); The Berkshire Gas Company, D.T.E. 98-129, at 8 (1999) (approved the use of financing proceedings to refinance debt originally incurred to finance contraction expenditures and system betterments); Essex County Gas Company, D.P.U. 92-188, at 7 (1992) (approved the use of financing proceedings to repay short-term debt, to finance construction work in progress and to meet the company's working capital requirements). Accordingly, the Company has demonstrated that the proceeds from the Term Loans are reasonably necessary for legitimate purposes in meeting the Company's service obligations.

In addition, the Company's net utility plant of $430,254,000 (which equals the Company's original cost of capitalizable plant, less accumulated depreciation) exceeds its total capitalization of $269,906,000 (the sum of its long-term debt and its preferred and common stock outstanding) by $160,348,000 and will continue to exceed its total capitalization following the proposed issuance of $150,000,000 in Term Loans, consistent with Colonial Gas Company, D.P.U. 84-96, at 5 (1984).

During the evidentiary hearing, Department Staff asked questions about whether it is appropriate to include debt that is due within a year from capitalization in the net-plant calculation.[8] The purpose of the net plant test is to protect investors from the impairment of capital. Eastern-Colonial Gas Company Merger, D.T.E. 98-128, at 103 (1999). The net plant test is designed to protect against impairment of capital by

8 If the $18.481 million in such debt is included in the capitalization, the net-plant excess is reduced to $141.867 million (Attachment RR-DTE-1).

comparing a company's long-term capital commitments to the value of its plant, a long-term asset. G.L. c. 164, § 16.

Allowing the Company to exclude its long-term debt due within one year from its calculation of net plant is consistent with Department precedent allowing companies to exclude short-term indebtedness (debt that is due within one year) from their calculation of total capitalization in the context of determining net plant. See Southern Union Company, D.T.E. 01-32, at 4, 10-11 (2001), Southern Union Company, D.T.E. 01-52, at 9-10 (2001). The governing consideration for the Department in determining the treatment of long-term debt due within one year should focus on when debt is actually due and payable (i.e., maturing), not the stated or nominal maturity over the entire life of the debt.[9]

In many cases, the Department has not counted maturing debt in the capital structure for purposes of applying the net plant test where the proceeds of a new issuance were to be used, in part, to retire "currently outstanding or maturing long-term debt" because "the Company's total stock and long-term debt will not exceed the Company's net plant after the proposed issuances." Western Massachusetts Electric Company, D.P.U. 91-269, at 7, 9-10. In view of the fact that $18,481,000 of debt will be paid by June 30, 2003 (Exh. CE-3, "Long-term debt due in one year"; Tr. 1, at 10),[10] the Company believes that it is consistent with prior Department orders to exclude such debt for purposes of the net plant test. Finally, although not controlling, generally accepted

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9 This is also consistent with G.L. c. 164, § 14, which refers to debt "payable more than one year after the date thereof."

10 The record also shows, more specifically, that more than $1 million will be paid on January 1, 2003 and $15 million on March 3, 2003 (Tr. 1, at 11-12).

accounting principles do not include debt to be repaid within one year as long-term debt (Tr. 1, at 13; Exh. CE-3).

Thus, consistent with Department precedent, the $18.481 million of debt as of June 30, 2002, that is due within a year should not be included in the net plant calculation.[11]

V. CONCLUSION

The record in this proceeding shows: (1) that the Company's Term Loans issuance is reasonably necessary to accomplish a legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14; and (2) that the Company's net-utility plant equals or exceeds it total capitalization and will continue to do so following the proposed issuance, pursuant to G.L. c. 164, § 16. Therefore, for the reasons stated above, the Department should:

VOTE: That Commonwealth Electric Company may enter into one or more Term Loans, from time to time, of not in excess of $150 million aggregate principal amount, and that such transactions are reasonably necessary for the purposes for which such transactions have been authorized, pursuant to G.L. c. 164, § 14.

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11 Although, for the reasons cited above, the Department should not require the Company to include its long-term debt due within one year in its capitalization calculation, the Department may alternatively allow the Company to structure its issuances of indebtedness so as to avoid any arguable impairment. When the Department approves the issuance of evidence of indebtedness by an electric company, if it determines that the fair structural value of the plant owned by such company is less than its outstanding stock and debt, and it may prescribe such conditions and requirements as it deems best adapted to make good within a reasonable time the impairment of the capital. See G.L. c. 164, § 16; see also Western Massachusetts Electric Company, D.P.U. 90-67, at 12 (1990). Accordingly, the Department may condition approval of the Company's financing request so that the Term Loans are initially limited to $141.867 million, and can increase to $150 million only as additional long-term debt obligations are reduced.

VOTE: That the Term Loans are in accordance with G.L. c. 164, § 16 in that the fair structural value of the Company's property, plant and equipment and the fair value of the electric inventories held by the Company, will exceed its outstanding stock and long-term debt.

ORDER: That the Department approves and authorizes the Company to enter into one or more Term Loans, in conformity with all the provisions of law relating thereto, of up to $150 million principal amount.

Respectfully submitted,

COMMONWEALTH ELECTRIC COMPANY
d/b/a NSTAR ELECTRIC

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